QUESTIONS OF LAW ENCOUNTERED IN TIMBER BOND ISSUES

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It will readily be seen that it is not the purpose of this paper to give instruction in the various questions of law that arise in the course of preparing a timber bond issue, but merely to suggest some of the many questions that must be confronted in every issue of such bonds, and the procedure with reference thereto.

The first inquiry made by the bonding house that is asked to bring out an issue of timber bonds is as to the security for the issue. This comprehends, first, the moral standing of the proposed borrower; second, the amount and value of the property that is to be mortgaged to secure the payment of the bonds, and third, the title to this property. Sometimes all of these things are investigated contemporaneously, but as a rule the expense of the examination of the titles is not incurred until after the cruise of the timber has proceeded far enough to indicate that the amount of the security will likely prove satisfactory.

Early in the history of timber bond issues it was not unusual for the purchaser of the bonds to depend upon the correctness of abstracts of title that were furnished by the borrower, and largely upon the opinion of the borrower's local attorney as to the validity of the titles. At first impression this appears to be a safe method of doing business, as no one can be quite as much interested in seeing that the titles are perfect as the owner himself, and no lawyer from a distance can know as much about the titles as can one who has for years lived and practised law in the vicinity. But the very information which is gained by familiarity with the titles themselves oftentimes leads to disadvantage in connection with a bond issue. The local lawyer may and often does approve titles on his own knowledge of their condition. The bond house must not only know that the titles are good, but must know that the records show them to be good. Otherwise it would soon have to go out of business for want of buyers. For, notwithstanding the reiterated statement that investors are

like sheep and the just-as-often-repeated allegation that capital is timid, yet not only the public at large but particlarly investors know that real estate titles are properly matters of official record, and but few are to be found who would be willing to buy a bond based upon timber lands to which the titles were in doubt. The very fact that an investor seeks or accepts a timber bond indicates that he is relying upon the fact that the mortgage to secure its payment creates a lien thereon, and as a rule a first lien; and this can only be done by the record. The vital question, therefore, is, what do the records show? The maker of the bonds may be of the highest standing; every other surrounding circumstance may commend the bonds, and the timber may be abundant and worth many times the bond issue, but it matters not how valuable the timber may be, the bonds would be worthless as timber bonds, and the mortgage would create no lien to secure their payment, if, in fact, the maker of the mortgage did not own the timber. Property owned by one person cannot be taken for another's debts merely because that other person may have claimed it. If there be one point in connection with a timber bond issue that cannot be waived, it is that of title. Everything else depends on it, and if the titles fail the issue fails.

The necessity is manifest, therefore, that every care should be taken in connection with the inquiry as to who owns the property. In sectionized land titles to large areas have been lost by the changing of one letter or of one figure. Section 22, Township 1 N., Range 6 E., is an entirely different six hundred and forty acres from Section 22, Township 1 S., Range 6 E.; and Section 22, Township 1 S., Range 6 W., is still another six hundred and forty acres, and seventy-two miles removed from the first description. It does not require cupidity to mistake an N for a W, or an E for an S; or even to confuse a 5 with a 3, or 6; or a 3 with a 2. Especially where the records have not been kept by skilled clerks is it easy to make mistakes in such figures or letters. Not only so, but it is possible for various reasons for an abstractor to overlook a mortgage or even a deed that may be of record. He may have inadvertently turned two pages at once. His attention may have been diverted and upon returning to the work he may have skipped a conveyance; or, relying upon the indices, as far the greater number of abstractors do, he may have failed to note an instrument because it was not properly indexed, or perhaps not indexed at all. It may be that the abstractor is not

a competent real estate lawyer, and he may therefore not know what may properly be omitted from an abstract and what it is important should be included. Or he may be ignorant of the significance of other things that to the experienced investigator might affect the title.

A few illustrations will suffice. On the table on which this writing is being done there is a memorandum showing the following items that were omitted from abstracts that were furnished as corectly showing the condition of the titles to lands that were offered as security for bond issues: A $10,000 mortgage was omitted in one instance and a $2,000 mortgage in another. A judgment for $2,400 which was a lien on the land had been overlooked by one abstractor, and a $600 judgment by another. Three tax sales escaped notice in one batch of abstracts, and one or more in many others. In fact it is quite common for delinquent taxes and tax sales to be overlooked. In an abstract quite honestly, painstakingly and elaborately prepared thirty-six mortgages were omitted, because the abstractor thought they were barred by the statute of limitations. He was mistaken in the law. As a matter of fact, they had been paid, although not cancelled of record. But a properly prepared abstract should have shown them even though they had been both cancelled and old enough to be barred. A deed which was signed by several persons was omitted, because it had been indexed under the name of only one of the grantors, and not the one through whom the abstractor was tracing his chain of title. A condition appearing in the face of the deed, and which defeated the conveyance, was omitted, the abstractor not knowing its importance. Recitals in a deed which under the law put a proposed purchaser on notice, or at least required him to make further inquiry of facts not shown on the record, were deemed of no consequence and found no place in the abstractor's notes. And it is so common as to be the expected thing that abstracts shall omit to call attention to defects in the certificates of acknowledgment to conveyances, although most states require such certificates and in many states the conveyance is void unless the statutory certificate be followed.

Absolute accuracy is requisite for a correct examination of titles. The only way to assure this is first to employ as accurate a person as can be found, and then to have the work checked and rechecked until the possibility of mistakes is reduced to the minimum. The correct method of doing this is for the owner to furnish complete

abstracts of title compiled by some reputable abstractor or lawyer in whom he has confidence, and for the bond house to have these abstracts checked by persons selected by itself, and who have established a reputation for accuracy and thoroughness in matters of title. The mere fact that the work has been accurately compiled and thoroughly checked is not sufficient. The investor wants to know upon whose work he is relying. If assurance cannot be given him that this accuracy is vouched for by some person known to him either personally or by reputation, to be experienced and thorough along these lines, then the investor will probably prefer to buy other bonds that are vouched for by some one whose work he knows can be depended on.

The above proceeds altogether upon the presumption that no conscious effort is being made to deceive the bond house and get it to accept an incorrect or incomplete abstract of title. And yet it is possible for even claimants of timber lands and proposed makers of bonds to be secured thereby not to make full disclosure with reference to their titles. A case is in mind where a man of good standing applied to a timber bond house to underwrite a $500,000 bond issue on a body of timber worth many times the proposed issue. The terms were satisfactory, and he produced beautifully prepared abstracts showing perfect titles in himself. The deeds to him were quite recent, and he frankly explained that he was just becoming interested in the properties, that the titles had been deeded to him as a matter of convenience, and that the person who had made the conveyances to him was really the "big man" in the enterprise, but that this "big man" lived at a great distance and was too much engrossed with other affairs to handle the detail of the bonding transaction, hence his intervention. He wanted $75,000 or $100,000 on a temporary mortgage within thirty days, but the remaining $400,000 or $425,000 could take the usual course, incur the delay incident to printing the mortgage, lithographing the bonds, etc., just so it should all be paid within six or eight months. Investigation developed the fact that the abstract was fraudulent; that the "big man" had purposely procured not merely one but many conveyances to be omitted therefrom in order that it might indicate that he had a clear title to the property, whereas he had merely bought what is known as a "wildcat" claim from a regular dealer in fraudulent titles; and he had then duped a mining engineer of good standing

to go into partnership with him ostensibly to work the minerals with which the land was underlaid; had deeded the lands to the dupe and had him to take up the question of bonding the property and of applying for the short time loan of $75,000 or $100,000. If it had been procured, the "big man" would have been $75,000 or $100,000 ahead and would probably never have been heard of again.

It may be considered either queer or merely a coincidence that, since the preceding sentence was written, another concern with a high sounding name on beautifully engraved stationery has applied to the same bonding house to which the above tract was offered, for a temporary loan of $100,000 on 621,000 acres of land, preparatory to a $5,000,000 bond issue to be floated as soon as the development work shall be well under way. This application was accompanied by exhaustive reports on the timber, coal, soil, climate; transportation facilities, and in fact everything that would naturally be taken into consideration in the making of a bond issue. There were also numerous photographs showing the timber, coal openings, and the operations in both. A map of this empire was also appended; and, of course, a beautifully prepared abstract and certificate thereto showing not a fly speck on the title of the company-with-the-steel-engraved-name. And yet this 621,000 acres included two-thirds of the same land that but sixty days ago was claimed by the man wanting the $75,000 or $100,000 temporary loan, although the literature (in the Carnegie libraries it could be classed under "fiction") of this steel-engraved-company showed that it had owned the land for years.

The 621,000-acre man had overdone his work, however, as the picture of his domain shows railroads running through his kingdom which were not there last week, when the writer hereof happened to have been through that territory.

The fact is that neither of these claimants owned the land on which they sought to float bond issues, and for want of a better name they might be called "promoters." They had heard that some bond houses accept abstracts of title that appear to have been intelligently prepared, so they presented abstracts in the preparation of which intelligence predominated. They were beautiful. Just a few years ago these plans might have worked, but bond houses are more careful now than they were then.

If either of these schemes had been successful, that bond house would not only have lost the entire amount of the issue, but unless

the scandal had been hushed up, its prestige would have been seriously impaired.

What is considered the importance of this particular phase of title examination will be made the excuse, even should it not by others be considered a justification, for one more illustration. A person who proposed to float an issue of timber bonds presented well prepared abstracts showing clear titles. Upon investigation it was learned that by a change of county lines a large portion of the property involved had for a number of years been in a different county. The abstract took no note of the records of this other county. Fifteen conveyances were found therein which affected the titles to the land under consideration.

It may, therefore, be considered as now settled that the bond house should have the original records investigated under its own direction; and the maker of the bonds should desire it to be done, for if default should be made in one timber bond because of failure of title it would materially affect the market for future issues for a long time to come.

As an illustration of this, the defaults that were made several months ago in a couple of irrigation bond issues utterly ruined the market for that class of securities. This went to such an extreme that many irrigation projects of unquestioned value and security were unable to finance themselves on any terms. One is now in mind that has property worth $1,500,000 and, with income that will pay interest on $2,000,000, wanted to borrow $500,000 for further development of its property, each and every dollar of which would have increased its income. The four principal stockholders, who were worth over $1,000,000 each, and an aggregate probably of $6,000,000, stood ready to personally guarantee the payment both of principal and interest on the bonds. But the recent defaults in irrigation bonds had wrecked the market for that class of securities. The timber market is probably as sentitive.

What has been said presents a question largely of practical consideration and may therefore be considered as a departure from the subject assigned, but it is so common to leave matters of title and all kindred questions to the determination of counsel that, whether merely practical or both practical and legal, the whole question of titles has to be handled by the lawyer, and is properly a question for his consideration.

Another question closely akin to the preparation of the abstracts, is, whose opinion shall be sought on the titles to the property to be covered by the mortgage.

The lawyer living in the county where the property lies may be just as able, honest and painstaking as any one who could be selected by the bond house. The ultimate investor, however, can hardly be acquainted with the ability and standing of these lawyers in various parts of the country, and as the lawyer's opinion is the only guaranty there can be that the titles are good, and that the mortgage creates a first lien on the property described therein, it is natural that he should hesitate before purchasing bonds, the value of which depends altogether on the honesty, ability and care of a lawyer of whom he has never heard; and many decline to do so.

Illustrative of this tendency, a short time ago a well known bond house brought out a large issue of timber bonds and, which was unusual, every bond was sold by the time they were ready for delivery. Some comment was caused by the fact that another bond house that usually confined itself to municipal issues had subscribed for $100,000 of these timber bonds. It was shortly explained in a letter from the purchaser stating that he had bought the bonds because the prospectus showed that the entire proceedings, including the examination of the titles, had been conducted by a lawyer whom he knew and on whose opinion he was content to rely.

Both the maker of the bonds and the house that brings them out are interested in having as wide a market for them as possible, as the more contracted the market the lower price they bring, and the wider the market the higher the price. The result is, therefore, that the better bond houses have learned that it is cheaper for the maker of the bonds, and more profitable for the underwriters, for all the legal work, and not merely the drafting of the bonds and the mortgage, to be done by well known experts in that line. This includes both the examination of the original records and the opinion on the title as well. For notwithstanding the abstracts may have been accurately compiled by the local abstractor, yet he and his work are unknown to the investor; and no matter how able and well known the attorney may be, his opinion on the titles could be no more reliable than the abstracts upon which his opinion might be based. Regardless of the ability and honesty of the local lawyer, there may be and there are liable to be matters

of record that could more judicially be passed on by some other person.

As a rule, persons proposing to issue bonds are of opinion that their titles are perfect, and rather resent the critical examination to which they are subjected; but it is seldom that they are not converted before the transaction is closed. A case is now in mind where some really competent business men, who had for many years owned the property which it was proposed to make the basis for the securities, stated that their titles had been looked after by a certain lawyer of more than local reputation; that they always consulted him about every step taken, and they expressed the opinion that it should not be necessary to incur the expense of the re-examination of the records by other persons. Before that transaction was closed more than a hundred unrecorded title papers—some of them mildewed so they could hardly be read—were fished from their vaults and filed for record. Their titles really were good, but the records failed to show it. Needless to say, their lawyer had not attended to the registration of their muniments of title.

In another instance, the proposed borrower scarcely concealed his resentment at what he considered an unnecessary and almost impertinent investigation of his titles, asserting that his secretary was a skilled conveyancer and had personally attended to the details of his titles for several years past; yet, as one result of that investigation it was disclosed that there was a serious claim of title outstanding to the site on which he was preparing to erect a most expensive mill. As this disclosure came before his mill had been erected, he was able to purchase the conflicting title for a comparatively small sum. What it would have cost him if the mill had been built before the defect in title had been discovered, is a matter of conjecture. The effect was, however, to cause him immediately to employ expert title attorneys to examine the records pertaining to all his other property—quite a large area—and he did not further object to the work of the attorneys representing the bond issue.

Recently a proposed borrower assented that an attorney for a bond house should examine his titles, but stated that as they had shortly before been approved by a prominent local lawyer who had formerly been a district judge, and who, at the time, had just been nominated for a place on the supreme court of his state; that it would probably require but slight investigation to satisfy the proposed bond buyers.

It proved another case where the local lawyer knew that the titles were good but where the records failed to show it. The lawyer had lived in that community for fifty years, and had for almost equally as long been the attorney for most of the old settlers, from whom the greater portion of the lands had been bought. He knew that Jane Jones, the wife of John Jones, and Sarah Brown, the wife of George Brown, were the only heirs of Hezekiah Robinson, who died ten years ago, and that they had made an oral partition of Hezekiah's property, by which Jane got the mansion house and contiguous fields while Sarah took the timber land for her portion. He also knew that Ben Johnson had paid off the $5,000 mortgage to Samuel Thompkins, for it had been paid to him as Thompkins' attorney. He also knew that the deed of May 16, 1896, conveying to Edward Jernigan a tract of land bounded on the north by the lands of Josiah Higgins, on the east by Dwight and McLeod, on the south by Miller and Zarecer, and on the west by Slemons and O'Connor, described the same property which Jernigan sold in 1902 to Robert Keeble, although this latter deed described it as bounded on the north by the county road, on the east by Rust and Stockell, on the south by Blake and McVeigh, and on the west by Wynns.

The judge was doubtless right in his recollection of these facts, and his opinion that the person who proposed to issue the bonds could make a good title was correct; but the trouble was that the judge's recollections were not official records, and it took six months to reduce these facts to record form.

Answer may be made that, as a matter of fact, the titles were good and that the bonds would really have been secured by a mortgage on the property. That might be so, but unless it can be demonstrated in some manner known to be reliable that the title is good, and the records are for that purpose, investors will not buy the securities, and should there be foreclosure no one would pay a fair price for the property.

Contemporaneously with the investigation of the titles of the property to be mortgaged, the attorney representing the bond house will take up many other questions, some of which are indicated below.

If the bonds are to be issued by an individual, it is, of course, known that no investigation need be made to ascertain his right to issue them; but should it be intended for a corporation to make the issue, there are many inquiries to make.

First, is the company legally incorporated, and, if so, has it made its annual reports and complied with other statutes of the state of its organization, compliance with which is necessary to maintain its corporate existence. As there are forty odd states, it is necessary either to have or to have access to the local law books of the same number of states in order to determine what statutes must be complied with.

Recently a father and several sons, who had successfully conducted a small lumbering operation, decided to purchase more timber and extend their business. Preparatory to a bond issue they proceeded to incorporate. Investigation at the instance of the bond house first disclosed that the articles of incorporation were invalid, and, next, the cause thereof. Those good people had applied to their friend, the neighborhood justice of the peace, for their incorporation papers. Not conceiving that anything was beyond either his ability or his jurisdiction, the justice had essayed both to prepare the papers and to perform all official functions with reference thereto.

Leaving the bond issue out of consideration, one cannot be quite sure but that, in that particular case, the lumberman would have gotten along just as well with the justice's charter as with that of the secretary of state.

The next inquiry made is whether, under its articles of incorporation, the corporation has authority to acquire or hold timber lands, and, if so, whether this right is limited to the state of its incorporation or extends beyond its borders; and as some states prohibit corporations from owning or acquiring property of more than a stipulated maximum in value on pain of escheat, the question as to the value of its holdings is immediately presented, if it is either incorporated in, or if the proposed security is in, any of the states that have such statutes.

The next inquiry is as to the extent to which the corporation may become indebted, and what its debts will amount to should the proposed bonds be issued, as many states place limits of indebtedness upon corporations. Should the timber lands be in a state other than that of its corporation, then all similar laws in that state must be examined, and, in addition, it must be learned what requirements are made of foreign corporations desiring to hold property or to transact business in this second state, and whether the corporation in question has complied therewith.

Coupled with these inquiries is that as to the purpose for which the bonds are desired to be issued, as, although an individual may issue bonds or notes and do with them as he pleases, a corporation can only issue bonds for the purposes authorized by law; and in many states these purposes are quite limited. For illustration, certain Louisiana corporations can legally issue bonds only for construction, repairs, or the purchase of additional property or franchises. It will be seen, therefore, that a serious question is presented if the corporation should desire to make a bond issue in order to fund its floating debts.

There are analogous provisions in all of the states, but they differ widely, and, of course, it requires an examination of the laws of each state in which it is proposed to do business in order to know what is permitted and what is prohibited by the laws of that state. Every lawyer knows that these things can seldom be determined merely by reading the statutes of the state in question; and it is never safe to rely upon the statutes alone, as in nearly every instance it will be found that the statutes have undergone construction by the supreme court, sometimes with unlooked for results. As an illustration, it will probably surprise the laity to learn that a municipal charter which prohibits the board of aldermen from granting a franchise to run through the streets of the city to any gas company, electric light company, steam heating company, telephone company, street car company, or any other company whatsoever, without the franchise first being submitted to a vote of the people, does not require a franchise to a steam railroad to be so submitted. To some it would also be news to know that a charter authorizing a corporation to build dams and construct roads, to buy and sell real estate, to deal in merchandise, to open and work mines, mills and factories, to grind wheat and to manufacture flour, stoves, kettles, pans, rope and any other article whatsoever, would not confer the right to manufacture lumber or wooden ware.

While theoretically the law is an exact science, yet its construction and application are left to finite minds, and people's minds do not all or always work in the same grooves; hence even though two states should have identical statutes on the same subject, the construction placed upon those statutes by their respective courts of last resort is not necessarily identical (would that it were), and thus the necessity of going to the supreme court reports of every

state involved in any bond issue to determine nearly every question that may arise.

Furthermore, it is oftentimes a matter of doubt as to whether the laws of one state or those of another control, and, if so, to what extent.

Suppose, for instance, that a Wisconsin corporation owning two million dollars of assets in other states, and timber lands in Mississippi, should contract on January 15th with a bond house in Chicago to underwrite one and a half million dollars of bonds secured by a mortgage on the Mississippi lands, the bonds to be issued April 1st, and sold at a discount, as all such bonds are sold.

The question arises as to whether the contract is controlled by the laws of Wisconsin, Illinois or Mississippi.

If a Wisconsin contract, would the Illinois usury laws apply?

If an Illinois contract and legal in that state, would the fact that the corporation might not before March 1st file its annual statement, required by the laws of Wisconsin, invalidate the contract, or would it continue enforceable under the Illinois law?

Owning a total of more than two million dollars of assets within and without the State of Mississippi, would the law of forfeiture and escheat of that state apply to the lands there?

The Mississippi property having been appraised sufficiently high to justify a bond issue of a million and a half dollars, would it be presumed that it was worth more than two million dollars and therefore subject to escheat?

The property being in Mississippi, would there be a presumption that it was not worth more than two million dollars, and therefore only one and a third times the bond issue, thus prohibiting the investment of Michigan savings bank funds?

The questions referred to above should all be settled preliminarly to drawing the bonds and the mortgage to secure their payment, —yet the latter are the objects of all that goes before, and by many are considered the serious part of the work.

The bonds should be drafted first. They would be valid if in the form of ordinary simple promissory notes, but, if so, they would convey no information as to the amount of the issue, the security pledged for their payment, nor any one of a dozen other things which an investor would want to know before purchasing them; and as they are primarily made to sell, the very purpose of

their issue would be impeded if not prevented. As a rule, the bonds will follow a form often used before. They will certainly do so should the draftsman not study the laws of the particular states involved. If a Chicago bond house is underwriting the issue, they must, of course, comply with the Illinois law. Should the maker be a Minnesota corporation, they must not violate the laws of that state, and if their payment is to be secured by a mortgage on lands in Oregon they must accord to Oregon laws, else their collection would be unenforceable there. And they must not violate the uniform negotiable instrument law, else they would be unsalable in many states, and probably not negotiable in any. The laws of the various states do not greatly differ in their requirements in reference to negotiable instruments, so it is not hard to draft the bonds. However, there are some differences that must be heeded, as, for instance, in some states a provision for reasonable attorney's fees for collection in case of default would be unenforceable and possibly, on the ground of uncertainty, make the bond non-negotiable—the statutues or decisions requiring the amount or percentage of attorney's fees to be stated—while in other states a provision for a specific sum or percentage is forbidden and the requirement made that only "reasonable" attorney's fees may be collected; the theory being that anything more or less than "reasonable" compensation would be inequitable either to the maker or the holder of the bonds, and that what would be "reasonable" cannot be determined until it is known what services may be necessary.

As strange as it may seem to many, the question was for a long time debated as to whether the fact that a bond bore a seal rendered it non-negotiable.

These will illustrate the character of inquiries that should be made before the bond is drafted.

All of these questions and many more have actually arisen. Some of them are present in every bonding transaction, and they must all receive careful consideration.

It is easy enough for the lawyer who may be called upon to decide the various questions to keep on what is called the "safe side." All that this would require of him would be to decide every question in its most unfavorable aspect for the bond issue, in common parlance, to "turn down the titles;" to "turn down the charter," or to "turn down" anything else that might require close investi-

gation. By so doing he would always be on the "safe side;" but the effect would be that he would himself land on the under side, for either his clients would "turn him down," or else they would themselves be "turned down" by their own clientele; and either one or both soon go out of business.

It is, of course, intended that the timber bonds shall furnish absolute security to their purchasers. Some bond houses boast that they take no chances; yet in every issue there are many material matters of law presented for investigation and decision. It will not do to guess them off. Experience teaches that any matter that is slurred over without serious attention will become a Banquo's ghost. It is much easier and takes less time to prevent trouble than to get out of trouble after getting in, and to get into trouble on a bond issue would be a serious thing, especially, if it should be trouble that could have been avoided by proper care in the first instance.

After the bond goes to the engraver (lithographed bonds are more common, but with the increased importance of the business steel engraved bonds are coming into use), and while he is making it look like money, the lawyer will turn his attention to drafting the mortgage or deed of trust to secure the payment of the entire issue.

Such mortgages or deeds of trust take a multiplicity of forms according to the respective desires of the maker and the purchaser of the bonds, the ingenuity of both and of counsel as well, and the necessities or purposes of putting out the issue.

The only object to be accomplished is to afford proper security for the payment of the bonds and interest coupons upon their maturity. This should be done so as to give satisfactory assurance to the bondholders and, at the same time, so as to restrict as little as possible the operations of the maker of the bonds, as in most cases timber bonds are issued by companies actively engaged in the manufacture of lumber.

Some features are common to all such deeds of trust. They describe the bonds; convey certain property to trustees as security for the payment thereof; contain covenants to pay the bonds and interest coupons at maturity, and authorize foreclosure in case of default. These are all of the real purposes of the mortgage, but involved with those things are others that sometimes make scores of pages of reading matter.

The selection of the trustee or trustees brings up a serious

question. Individuals formerly served in that capacity. It was soon realized that natural persons die, sometimes quite inopportunely, and that they do other things that might make it awkward for them to be depended on to act whenever action might be necessary or desirable, such as get sick, change their business or their business affiliations, or they might be absent when action by the trustee was urgently needed; hence the use of artificial persons, corporations, generally trust companies, as trustees, became quite general.

While no state can prevent a natural person, a citizen of another state, from doing business in such state, yet any state can impose any condition which it may see fit upon a corporation of another state desiring either to do business or to own property within its borders, and may prescribe the terms upon which such foreign corporations may seek the protection of its courts. Not only so, but nearly every state in the Union has enacted legislation prescribing such conditions. The most common of these provisions are, that the corporation seeking admission shall pay a fee, generally graduated according to its capital stock, and shall make itself subject to suit in such jurisdiction. In some states corporations organized in other jurisdiction must become domesticated, that is, must be chartered under the laws of those states before they are permitted to acquire property or do business therein, or to seek the protection of their laws or of their courts. Occasionally such laws go to the point of absolute confiscation. The penalty of nullifying contracts is quite commonly visited upon corporations of one state that do business in states other than that of their incorporation without complying with these local laws. And when a contract is so nullified the person with whom the corporation has dealt may receive and hold the benefit of the transaction, but the corporation itself cannot recover the consideration.

A case is now in mind where a corporation loaned money on a mortgage on land in a state where it had not qualified to do business. There was a question involved as to the state in which the transaction really occurred. The decision was that the corporation attempted to do business in the state where the land lay without complying with the laws of that state, hence its contract was held to be void and unenforceable and it lost the full amount of money which it had loaned.

A more recent case was equally as disastrous. A corporation of one state had sold and delivered a large quantity of merchandise in another state in such a manner that it could not be called interstate commerce. The only defense to a suit on the debt was that the seller had not complied with the local laws prior to selling the merchandise. This defense prevailed and the seller lost its goods.

In another jurisdiction, the legislature has enacted that no corporation of another state can do business, acquire property, or bring suit in that state without qualifying as a local corporation, and under this statute a corporation was not permitted to maintain an action to recover property which it had bought and paid for, but which another person had taken possession of.

Some states levy large fines, such as one hundred dollars a day, against foreign corporations which attempt to do business without qualifying under their local laws.

It is manifest that the compensation of a trustee under a bond issue would not justify a trust company either in paying the fees necessary to qualify it to do business in those several states or in subjecting itself to suit therein, and but few, if any, corporations could be found who would do either.

This presented the question as to what were the trustee's duties and could they be performed without bringing the trustees within the provisions of such statutes as mentioned above.

The trustee's duties are inaugurated by acceptance of the trust and the vestiture of title. The trust can be accepted, and always is, at the domicile of the trustee. It may therefore be concluded that this would not be doing business in another state. But the question remains as to the acquisition of property. This can only be accomplished in the state where the property lies. Many of the states have statutes providing that title shall not pass by either a mortgage or a deed of trust (in legal literature they are different instruments), and in those states no difficulty is encountered in the inception of the trust. In other states the common law prevails to the effect that a mortgage or deed of trust does convey title; but the United States Supreme Court, and the courts of last resort in many of the states, have decided that what are known as disqualifying statutes do not prevent the technical vestiture of title in a foreign corporation, and that, even so, only the state itself could question such vestiture, and then only by appro-

priate proceedings instituted for the purpose. In addition, general equity jurisprudence is administered by some tribunal in every state of the Union, and equity will not permit a trust to fail for want of a trustee. So, in so far as merely taking title is concerned, it is safe to use a corporation as a trustee. And the bondholders, in so far as these disqualifying statutes are concerned, would have a perfectly valid mortgage and a legal trustee until a default might arise and the interposition of the trustee, in some manner hereinafter shown, should be necessary, at which time the corporation would not be qualified to act, although the need of its services would be then more imperative than at any other time. In other words, trust companies can be only fair weather trustees except in the state of their incorporation. After a few years' experience with trust companies as sole trustees, it was deemed best to use two trustees in timber bond issues, one a trust company, which should be empowered to act as sole trustee unless action should be necessary which it had not qualified itself to take under the laws of the state in which the land lay, and the other a natural person, to be empowered by the deed of trust to act in case the corporation should not be qualified to act. This plan is now generally followed. The day will doubtless come when some defaulting borrower will attempt to take advantage of what he may consider a technicality in his favor and contest the validity of such provision for two trustees, but the idea has been well thought out and the attorneys for the bond houses do not fear the results.

There has been some confusion as to just how far the duties of the trustee go. The trust companies themselves differ widely with reference thereto. Some of them construe their duties to begin and end with certifying the bonds and collecting their fees therefor. Others assume that it is incumbent upon them to cruise the timber, make a preliminary audit of the books of the borrower, and to lend much assistance in the investigation of titles and the preparation of the bonds and mortgage.

One extreme is about as wrong and unreasonable as the other. The real duties of the trustee, aside from its moral obligations, are those specifically imposed by the mortgage, and none other.

As a matter of policy, well regulated trust companies will not consciously accept a trusteeship except for a reputable mortgagor, nor if it has cause to believe that there is anything wrong or detri-

mentally irregular with the issue. Neither would it desire to accept a trusteeship where there was a presumption of an early default being made.

But such things can all be easily guarded by the trust company doing business with only reputable bond houses. All such houses make exhaustive examinations to determine these very questions, and are much more interested in the result thereof than the trust company can ever be. If the trust company cannot unquestioningly accept the conclusion of the bond buyers on those preliminary matters that might affect its reputation, then it should decline all dealings with those bond buyers.

It is customary for the mortgage to contain a clause by which the trustee expresses its acceptance of the trust and agrees to perform the duties incumbent upon it thereunder. The trustee, therefore, examines the mortgage in advance of its execution, to see if any duties or obligations have been imposed upon it which it is not willing to engage to perform. At the same time, it is careful to see that most ample provision is made negativing liability on its part except for money which may actually come into its hands or for bad faith in the performance of its duties. These points settled to its satisfaction, the trustee executes the instrument as an evidence of its acceptance of the trust, and after execution by the maker of the bonds the mortgage is put to record. Here occurs the vestiture of title, except in those states which have enacted otherwise, and here is where the disqualifying statutes heretofore referred to have been of concern.

So many mortgages provide that the bonds issued thereunder shall not be valid until certified by the trustee that it is common to consider the making of such certificates as inseparable from the duties of the trustee. This is erroneous. These certifications could just as well be made by some third person, and in view of the penalizing laws of the different states it would be well to distinguish between the duties of trustee proper and those of a mere certifying officer, or of other duties that may be, and ordinarily are, imposed upon the trustee. The mortgage itself should so differentiate, for fear that the confusion might some time lead to the inference that the certification would be illegal and the bond therefore not validly issued should the trustee be adjudicated unqualified to perform other duties incumbent upon it under the mortgage.

In order to prevent the risk of their loss, it is common to provide that timber bonds may be registered, as registration takes away their negotiability. It is as equally common to provide that the trustee shall be the registrar. Then, again, the bonds are ordinarily made payable at the banking house of the trustee, thus imposing upon it the duties of banker in addition to those of registrar and certifying officer and trustee proper.

Ordinarily, therefore, the trustee acts in four separate and distinct capacities: First, as certifying officer; second, as registrar; third, as banker, and fourth, as trustee. There is no reason, save that of convenience, why these duties should not be performed by separate persons or separate corporations. None of them except the last require action which could be construed as violative of the disqualifying acts of the various states with reference to non-resident corporations; and it would be better should the mortgage make sharp distinction between the various capacities in which the trust company is to act.

Generally speaking, the duties of a trustee, aside from the other duties above referred to, are: to adjust fire losses and collect the insurance; to co-operate with the mortgagor in retiring bonds that may be called prior to maturity; to execute partial releases of timber or other property whenever, under the terms of the deed of trust, the mortgagor may be entitled thereto, and a complete release and cancellation upon compliance with all the covenants contained in the deed of trust. All of these duties may be performed without "doing business" other than in the state of its incorporation. In the event of default, however, the duties of the trustee are quite active, may be quite varied, and must be performed wherever the property covered by the mortgage is situated, and also wherever the business of the mortgagor may lead. Under certain conditions, the trustee may be required to conduct the logging operations or to run the sawmill and other business of the mortgagor. Oftentimes he may even take charge of all the property embraced in the mortgage, including logging and manufacturing machinery and equipment, and conduct the business operations of the mortgagor to the same extent and as freely as the mortgagor himself might have done prior to the default.

As a rule, however, instead of itself entering and operating, the trustee will, upon default, seek the aid of the courts and ask that a

receiver be appointed to conserve the property and conduct the operations until foreclosure can be had. In such case its services, outside the state of its own location, would be largely those of any other litigant. As the trustee is the direct representative of the interests of the bondholders, and at least theoretically the only representative of such interests, it will be seen that even as litigant it can easily find many things to do towards safeguarding those interests.

Aside from the work and worry of conducting the litigation, the trustee will doubtless busy itself to the end of organizing bondholders' committees and assisting in the services thereof. In fact, it should actively contribute to any efforts that may be made to seeing that the bondholders do not suffer loss, and that there shall be no unnecessary sacrifice of the mortgagor's property.

The covenants to be included in a trust deed are of prime importance. Among those that are common and others that are not unusual are: For further conveyance in case it may be desired; to pay taxes before delinquency; to pay any judgment that might become a lien on the land or that might be put into an execution against the mortgagor; to keep fire insurance on the mill plant and other property usually insured by other persons engaged in like business; to keep in repair any machinery and equipment that may be covered by the mortagage; not to cut the timber covered thereby unless it be done in accordance with certain provisions that may be prescribed in the instrument; not to commit nor permit waste of any of the mortgaged property, and, what is imperative, to pay the bonds and interest coupons promptly at maturity.

The maker of the mortgage often assumes other obligations, and among them it is not unusual for the maker to covenant to diligently protect the property; to establish a system of fire patrol or other protection for the forests; to keep proper books of account, open to the inspection of the trustees or of the house that may buy the bonds, in order that its financial condition at all times may be known; to make provision for maturing obligations a few days in advance of their maturity; not to extend the maturities of either bonds or interest coupons except upon such conditions as may be prescribed in the mortgage. The mortgagor should be further obligated, in case of default, to consent to a receivership; to waive laws making for delay, and to pay attorneys' fees in the foreclosure

proceedings, should such be had. Occasionally an operating company contracts that it will keep a specified minimum of "working capital." This latter provision is quite salutary under some circumstances, but it can easily be converted into an unnecessary annoyance.

The above are only items in the covenants—agreements, obligations, contracts of the mortgage. Each of them must be appropriately expressed in apt words to convey just the meaning intended, and to avoid infraction of the laws of the state of the mortgagor's incorporation, as well as of the state in which the contract may be made and that in which the property may be situated.

The next consideration is probably to provide a method by which the mortgagor may cut and remove timber, in order that his operations may not be unnecessarily impeded by the bond issue. If the maker is operating a sawmill, provision must be made by which he can use the timber as his necessities may demand. This is usually arranged either by periodical payments of an agreed amount per thousand feet on the lumber as it may be manufactured or sold, or by the payment of a stipulated sum per thousand feet for the stumpage before it is cut, to be ascertained according to estimates agreed upon when the mortgage is made. As a rule, the latter plan is more acceptable both to the bond house and to the maker of the mortgage. To the bond house, because it gives assurance that no timber shall be cut without the bondholders are first paid the value thereof. To the maker of the mortgage, because timber will "run over" in the manufacture, that is, more feet of lumber can be manufactured from a tree than the same tree will be estimated at in the woods, and thus the maker's enforced payments are not so large as if they were made on his actual production. Again, if payments should be made as the lumber may be manufactured, the question of grading and classifying the product must be taken into consideration, as well as many other things that may multiply the work of accounting. Both makers of mortgages and bond houses like to avoid the necessity for much bookkeeping, frequent reports, and the laborious verification thereof which would be necessitated by provisions for payment upon the basis of the manufactured product.

These and other things that may assure safety of the bonds and not embarrass the operations of the maker of them have to be worked out by a practical lumberman, and then put in enforceable form by the person drafting the mortgage.

Owing to the difference in the laws of the various states, it cannot always be safely assumed that what would be legal in one state would be enforceable in another, so many mortgages are drawn with saving clauses to the effect that the invalidity of any one or more provisions thereof shall not affect the validity of the remainder of the instrument.

On the whole, therefore, those documents attempt to take care of all contingencies that are likely to arise, many that may arise, and some that could not arise save in the imagination of a timid investor, and then, like this paper, conclude with the litany praying excuse "for the things that have been left undone that ought to have been done, as well as for those things that have been done that ought not to have been done."